THE ORGANIZATION OF INSURANCE POOLS IN JAPAN

AUTHOR(S):

Sawa, Sempei

CITATION:

Sawa, Sempei. THE ORGANIZATION OF INSURANCE POOLS IN JAPAN. Kyoto University Economic Review 1940, 15(1): 60-67

ISSUE DATE:

1940-01

URL:

https://doi.org/10.11179/ker1926.15.60

Kyoto University
Economic Review

MEMOIRS OF
THE DEPARTMENT OF ECONOMICS
IN
THE IMPERIAL UNIVERSITY OF KYOTO

VOLUME XV
1940

PUBLISHED BY THE DEPARTMENT
OF ECONOMICS IN
THE IMPERIAL UNIVERSITY OF KYOTO

THE ORGANIZATION OF INSURANCE POOLS IN JAPAN

By SEMPEI SAWA

The reinsurance market in Japan deals almost exclusively with property insurance, exhibiting very limited interest in life insurance. The so-called insurance pools are organizations which play án important rôle in reinsurance, their chief function being the averaging of risks. Insurance pools in Japan, however, have been established for purposes differing from those recognised in other countries: hence they exhibit certain unique features in their organization. The present treatise deals, first of all, with these distinctive characteristics of insurance pools in Japan; and in the second place, with certain tendencies which have recently become apparent in their organization. Subsequent to the outbreak of the China Incident, the reisurance market or insurance pools have been forced, for economic and political reasons, to undergo certain drastic reorganizations, which have already been partially effected.

Stimulated by the development of prosperous maritime transportation business during the last European War, a great number of fire and marine insurance companies came into existence in Japan in a somewhat haphazard manner. The number of registered fire and marine insurance companies, (respectively 20 and 11) at the outbreak of the World War, was more than quadrupled in the post-period. The subsequent crisis in financial circles and Kwanto earthquake disaster combined to cause a substantial reduction in the number of these companies. There still remained, however, such an excessively large number of underwriters that the business was constantly depressed and reckless competition in premium reduction prevailed. Although efforts were frequently made to establish higher rates, they failed to achieve the desired result. It was only toward the end of the *Taisho* Period and subsequently (1926—1930) that the time became ripe for the adoption of standard rates. However, the agreements adopted then represented more than a mere fixing of premiums. The underwriters, who had suffered bitter experience of having their tariff agreements reduced to a dead letter by secret rebates and other illicit practices, now attempted to establish tariff-associations reinforced by reinsurance. The so-called eight-companies pool, established in the fire insurance field in June, 1926, was the first attempt along this line. (This pool, however, was destined to be short-lived, having been dissolved toward the end of 1927, probably due to the fact that the foundation for this type of agreement had not yet been adequately prepared).

A similar opportunity presented itself almost simultaneously in the marine insurance field. In contrast with the short-lived fire insurance pool, the pools in the marine insurance field seemed destined for a very prosperous future. It should be noted, however, that for many years after the World War, the marine insurance market also suffered from a superfluity of underwirters and resultant reckless competition in premium cutting, which ultimately involved many underwriters in business failures. As a result of the persistent efforts of underwriters to counteract such adversities, many insurance pools were brought into existence in the field of marine goods insurance, during the period 1927 to 1930.

In consequence of the establishment of these pools, there developed considerable alterations in the nature of the marine insurance market. By means of the pools established to counteract business depression, insurance companies began to assume a monopolistic position. Having suceeded in enforcing rates-agreements by means of mutual reinsurance through the medium of insurance pools, the insurance capitalists were able to impose considerably higher premium rates than heretofore. It is true that these pools could by no means ensure complete harmony of interest among all the members. Nor is it certain that the agreements on rates were always adhered to strictly by all parties. Nevertheless, there is no denying that the market has undergone a remarkable transformation as a result of the more or less complete monopolies established by means of the pools.

An immediate object of insurance pools is, generally speaking, the averaging of insurance risks. It is superficial to say that the insurance pools in this country aim at this object. Nevertheless, their primary purpose was to monopolize the market and to limit the disastrous competition resulting from the superfluity of insurance companies in the post-war period. For this reason, they have always insisted upon the inclusion of important clauses enjoining the strict observance of rate agreements. Actually, these pools have, without exception, effected considerable increases in premium-rates immediately after their incorporation. This constitutes the unique feature of the insurance pools in this country. Upon consideration of the *modus operandi* of these pools, it is found that there are many members who do not exchange reinsurance with other members. This is evidence of the fact that our pools were not organized primarily for the purpose of distributing insurance risks. So long as they are able to maintain favorable premium rates, underwriters do not consider it necessary to bind themselves by participating in mutual reinsurance transactions.

Moreover, these pools adopt uniform pooling-ratios or reinsurance quotas, instead of differential quotas, applicale to all their members equally. In so far as the pools are operated to average insurance risks, each underwriter is, theoretically, at any rate, expected to adopt a reinsurance quota proportionate to his original insured values. But in riew of the special condition above mentioned, a uniform quota is generally employed in our reinsurance-pools. Because of this uniform ratio, insurance companies with relatively large original contracts are compelled to work for the benefit of other underwriters, without enjoying corresponding advantages. Under the circumstances, they merely remain their pool memberships without participating in the mutual reinsurance league. In other words, under the system of a a uniform reinsurance quota, members with large original contracts would be obliged to accept reinsurance of relatively smaller amounts from others, with the result that their net contracts are reduced to correspondingly smaller values. As a result, therefore, of participating in reinsurance business, they actually do a smaller volume of business than would otherwise be the case. Consequently, they naturally refuse to participate in mutual reinsurance conferences, remaining in the pool merely with the object of enjoying the benefit of the agreed higher rates.

Not all the pools, however, have adopted uniform quotas from their inception, for some of them had previously settled upon differential quotas in proportion to original insurance values. The Crab Processing (Kanikosen) Marine Insurance Pool, for example, adopted quotas proportional to original values early in its history. On the other hand, there are pools which are now allotting to their members reinsurance quotas determined on the basis of original values. The War-risk Marine Insurance Pool and the Wool Marine Insurance Pool are organizations belonging to this group.

In the marine goods insurance pools in this country, the ratio reinsured to other underwriters is relatively small. By corollary the quota of self-retention is relatively large. Thus, in these pools, the ratio of reinsurance business offered to other insurance companies ranges between 40.5 per cent and 56 per cent of the value of the original contracts. In other words, about half of the original values are offered for pooling and the rest are retained within the company. This ratio seems to be considerably smaller than in the case of insurance pools in other countries. Insurance pools in Germany, as we know, make it a rule that members pool almost the whole of the original risks for reinsurance, only allowing a small portion of self-retention, a provision which is disigned to stimulate interest in the original risks and to encourage faithfulness to the original contracts. This difference between the pools in the two countries is the natural outcome of the fact that while the German pools are organized primarily for the purpose of risk averaging, those in Japan aim mainly at the maintenance of higher premium rate agrements and market monopoly. In fact, insurance companies in our pools combine in order to maintain the rate of premiums at the agreed higher level. This is clearly evidenced by the fact that in the Korean-Rice Pool, the proposal made in April, 1933 by one of its members, the Teikoku Marine and Fire Insurance Co., for an extension of reinsurance quotas for the purpose of obtaining a more complete averaging of risks, was rejected on the ground that "such a move was a virtual application of socialistic principles to the pool agreement."

A distinguishing feature of the underwriters' pools for marine goods is the fact they have no central pooling office and are combined loosely by agreements for the mutual exchange of reinsurance business. In the absence of a central organ through which insurance risks can be " pooled," in the strict sense of the word, each member offers reinsurance business to other members directly and individually. Therefore, the delivery of reinsurances, payment of reinsurance premium and claims, and other details are arranged directly between the members. In this respect also our system of insurance pools differs considerablly from similar organizations in other countries.

Let us now consider the organization of our hull insurance pool. During the past ten years, the hull insurance market in this country has been placed under the control of the organization known as the Hull Union. Like marine goods insurance pools, the Hull Union was organized for the stabilization of premium tariffs which had been demoralized by the cutthroat competition of the underwriters in the post-war period. The Union, which was established toward the end of 1927, determines for each member, in accordance with his past business record, premium rates and other terms relevant to the annual insusance contracts of each vessel or fleet. Furthermore, to encourage the members to adhere to the designated rates and terms, the Union specifically requires that each member shall reinsure 20 per cent of his original insured values among the other members. In so far as these practices are concerned, the Hull Union is an insurance pool in the same sense that the marine goods pools are insurance pools. However, since the Union is more interested in the maintenance of agreed rates, the averaging of risk is not necessarily regarded as of such moment matter; hence the reinsurance-ratio of only 20 per cent. The control exercised by the Union over the hull insurance market is almost complete, and sets a standard for the other insurance pools. In recent years, however, the Union has been compelled to undertake drastic alteration in its organization. The present Sino-Japanese emergency has made it imeprative to improve the balance of our international trade, and with this in riew, the government adopted in the autumn of 1938 a policy of restricting the sale of reinsurance towards foreign markets. Faced by this new situation, the Union has been compelled to transform itself from a monopoly organization into a pure insurance pool operating primarily for the averaging or distribution of insurance risks. It is regrettable that limitations of space prevent a detailed discussion of this phase of the subject in the present treatise.

It is clear from the foregoing discussion that for many years the principal market of insurance pools in this country was mainly the field of marine insurance. More recently, however, pools have begun to be organized in other departments of insurance. For example, the fire insurance market now manifests a strong tendency for organizing pools. The Textile Mill Fire Insurance Pool established in Fukui Prefecture in May, 1937 is a unique organization of its kind. This pool, like the marine pools, has maintained premiums at a high level by means of a monopoly of the market. But this alone does not constitute its primary purpose, for the distribution of risks is regarded as an equaully important goal. This will be seen from the fact that the pool, which protects factories from fire risks, requires that 70 per cent of original values be reinsured. We are also given to understand, from the newspaper reports appearing in April, 1939, that the Japan Fire Insurance Association has projected the establishment of a pool organization for factory fire risks on a national scale. Since this pool is said to have proposed a fundamental revision of premium tariffs, it is apparent that it, similarly with other pools, work for the maintenance of higher rates and an eventual monopoly of the market. It is reported, however, that the establishment of this pool has been proposed in consequence of the recent restriction imposed upon marketing reinsurance to foreign underwriters. It would seem likely, therefore, that the pool in question will strive primarily, not to monopolize the market, but to secure greater domestic absorption of risk, by means of a more effective distribution of insurance risks through mutual reinurance.

In addition to the pools described above, there is in Japan an aeronautical insurance pool that has been in operation since 1937. Hitherto this type of risk has generally been offered to foreign reinsurer. It was feared, however, that in view of the recent seriously strained international relations, reinsurance of this type might become a medium for divulging confidential information relative to capacities of aircraft, etc. Consequently, the sale of this form of reinsurance to foreign markets has been either greatly restricted or prohibited. At the same time encouragement has been given to a project to establish an organization for the pooling of these risks by domestic underwriters. It is apparent, therefore, that this pool has been brought into existence for the purpose of distributing risks rather than for securing a monopoly of the market.

We have endeavored so far to show that insurance pools in this country were originally established as a means of counteracting the postwar business depressisn and of maintaining insurance premiums at the desired higher levels, and that the pools were actually so organized as to fulfil these functions. After these goals were more or less achieved, the pools became to attach primary importance to the function of averaging insurance risks, which they had previously considered as only an incidental or as at best a secondary purpose of their organization. With this change in principle, the pools began to undertake a thoroughgoing reorganization consistent with the new purpose. Consequently the pools have recently extended their business into a new field to which they had hitherto paid little attention. The Chino Emergency and the impending crisis of another World War have been the most powerful factors prompting the development of our insurance pools in this new direction.